IFRS 10- Consolidated Financial Statements

(Few samples taken from our publication are presented below for your self assessment. For more, visit our E-Book Store section)

Scope

Question:

AB Limited holds majority voting shares in several companies. All of these investee companies qualify as subsidiaries of AB Limited within the meaning of the Companies Act, 2013. All of these investee companies also qualify as subsidiaries of AB Limited within the meaning of IFRS 10, Consolidated Financial Statements, since all decisions are taken by these companies on the basis of simple majority of votes.

AB Limited holds 48 per cent of the voting shares in Z Limited. As AB Limited neither controls the composition of the Board of Directors of Z limited nor it exercises or controls more than one-half of the total voting power of Z Limited therefore Z Limited does not qualify as a subsidiary of AB Limited within the meaning of the Companies Act, 2013. The voting rights in Z Limited other than those held by AB Limited are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. On the basis of the relative size of the other shareholdings, AB Limited has determined that a 48 per cent interest is sufficient to give it 'de facto control' over Z Limited within the meaning of this term under IFRS 10. Consequently, Z Limited qualifies as its subsidiary under IFRS 10.

In preparing its consolidated financial statements as per IFRS, should AB Limited also consolidate Z Limited?

Response

Rule 4A of the Companies (Accounts) Rules, 2014 issued by the Ministry of Corporate Affairs states as follows: "4A. Forms and items contained in financial statements The financial statements shall be in the form specified in Schedule III to the Act and comply with Accounting Standards or International Financial Reporting Standards as applicable.

Provided that the items contained in the financial statements shall be prepared in accordance with the definitions and other requirements specified in the Accounting Standards or the International Financial Reporting Standards, as the case may be."

Thus, it is clear from the above that for the purposes of preparation of financial statements, the definitions and other requirements specified under IFRS should be applied. As Z Limited qualifies as a subsidiary of AB Limited under IFRS 10, it should also be consolidated by AB Limited in preparing its consolidated financial statements.

Rights to direct different relevant activities

Question:

Investors A and B establish Entity C and each holds 50% of the voting rights. The shareholders' agreement between A and B specifies that:

- Entity C's purpose is to generate capital gains from investing in commercial property. Its activities are limited to buying, managing and selling properties that meet pre-determined investment criteria

- all decisions concerning major capital activities, including buying and selling properties, and associated financing activities, require the agreement of both investors

- Investor A is responsible for other day-to-day management activities, including marketing to prospective tenants, negotiating rental agreements, rent collection and property maintenance, security and insurance. Investor A is paid for these services on the basis of costs incurred plus a fixed margin.

Does Entity A have power over Entity C?

Response:

Analysis:

It is likely that the major capital activities and day-to-day management activities will both affect Entity C's returns to a significant extent. Investors A and B should therefore evaluate which set of activities has the greatest effect on returns.

In making this evaluation, the investors should consider the purpose and design of Entity C. Given that its stated objective is to achieve capital gains, this may indicate the capital activities have the most significant impact. If so, the conclusion would be that Investors A and B have joint control of Entity C because these activities are directed by joint decision-making. If however the day-to-day management activities are considered more significant, the conclusion would be that Investor A has control of Entity C because it directs these activities unilaterally.

Power of Major Customer

Question:

A Limited manufactures a single product P. It supplies almost 85% of quantity of product P manufactured by it to B Limited. Remaining 15% is supplied to other retail customers. B Limited neither has any decision making powers regarding the manufacturing operations of A Limited nor any other involvement in A Limited except placing purchase orders with it. The contract period is three years and can be renewed by mutual consent. If the contract is not renewed, then either of the entity is able to seek other customers and suppliers respectively. However, in case of early termination, penalties are levied on the terminating entity.

The board of A Limited operates and makes key decisions about its business independently. Further, A Limited is actively looking for new customers.

Whether B Limited has power over A Limited?

Response

Paragraph B19 of IFRS 10, provides that sometimes there will be indications that the investor has a special relationship with the investee, which suggests that the investor has more than a passive interest in the investee. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, having more than a passive interest in the investee may indicate that the investor has other related rights sufficient to give it power or provide evidence of existing power over an investee. For example, the fact that investee depends on the investor for critical services, technology, supplies or raw materials or that a significant portion of the investee's activities either involve or are conducted on behalf of the investor, suggests that the investor has more than a passive interest in the investee and, in combination with other rights, may indicate power.

In the present case, it seems that A Limited is economically dependent on B Limited for its sales. However, other factors needs to be evaluated to assess B Limited's control over the A Limited, e.g. power to direct the day to day operations making the key decisions, seeking customers and suppliers etc.

In the given case, A Limited has unilateral decision making powers over how to manufacture the product and is actively engaged in seeking new customers. Further, the key decisions about the business of A Limited are also made by the Board of A Limited without any involvement of B Limited. Thus, upon assessment of these factors it is evident that B Limited does not have power over A Limited.